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¶1. (U) Summary. This is Volume 8, issue 28 of U.S. Embassy Pretoria's South Africa Economic News Weekly Newsletter.

Topics of this week's newsletter are:
- Reserve Bank Steps Up Growth in Currency Reserves
- Big Dip in Business Confidence
- House Prices Rocked by Largest Decline in Fifteen Years
- Black Business and Professional Organizations Reject Ruling on Chinese
- New Vehicle Sales Slump 21.9%
- Airlines Hesitant to Fly Directly to Durban's New International Airport
- Nationwide May Come Out of Liquidation
- SAG-led AWCC Project Faces Further Delays
- ICASA Rethinks its BEE Stance
- Share Swap and Cash May See Ambani-led Group Buy a 51% Stake in MTN
- DTI Launches Rural Tourism Promotion Scheme

End Summary.

Reserve Bank Steps Up Growth in Currency Reserves

¶2. (U) SA's gold and foreign currency reserves increased by 1.3% to $34.9 billion at the end of June 2008. The foreign reserves build-up was supported by both the higher gold price and the SA Reserve Bank's (SARB) increased pace of foreign currency purchases. The SARB is under pressure to build reserves to cover the growing current account deficit and rising import requirements as the SAG steps up infrastructure spending. The current account deficit reached 9% of gross domestic product in the first quarter of 2008, the highest in 26 years, as record oil prices and infrastructure spending fueled imports. (Business Report, July 8, 2008)

Big Dip in Business Confidence

¶3. (U) The SA Chamber of Commerce and Industry (SACCI) reported that its Business Confidence Index slipped to 92.6 index-points in June 2008, its lowest level since October 2003. Business confidence is down 7.4% from 2000, when the index was set to 100. The index hit a peak of 103.5 index-points in December 2006, and has moved downwards since. SACCI asserts that its index does not have the "wild mood

swings of the opinion poll-based business confidence index done by the Stellenbosch University's Bureau of Economic Research (BER)" since SACCI calculates its index from data rather than opinion polls. The BER's Business Confidence Index plunged 19 index-points during the power crisis of the first quarter and then a further 3 index-points in the second quarter, taking it to 45 index-points. Less than 50 index-points indicate a contracting economy. The BER's Consumer Confidence Index decreased by 18 index-points in the second quarter of 2008 to -6 index-points , the biggest drop in 24-years and its first negative level since the first quarter of 2004. The BER's Purchasing Managers' Index, which is seen as a reliable gauge for the manufacturing sector, dropped from 49.1 index-points in May to 43.8 index-points in June. (Business Times, July 6, 2008)

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House Prices Rocked by Largest Decline in Fifteen Years
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¶4. (U) The latest ABSA House Price Index revealed that real house prices in the middle segment of the market dropped 6.3% y/y in May,
Qprices in the middle segment of the market dropped 6.3% y/y in May,
the biggest plunge in 15 years. Activity levels in the residential property market, as well as nominal and real house price growth, are expected to taper off further from current levels towards the end of 2008 and into 2009. Nominal house price growth is forecast to slow to around 5% in 2008 and slowing further to 4% in 2009. Short-term indicators, such as new vehicle purchases and retail sales, continue to suggest a slowdown in household spending. This slowdown plus the negative wealth effects associated with slower house price growth, a tighter credit environment, falling consumer confidence levels and uncertainty around employment prospects are expected to continue to weigh on economic activity. However, considering the upside risks to inflation emanating from rising food, fuel and electricity prices, second-round inflationary pressures and rising inflation expectations, it is unlikely that the slowdown in growth will sway the inflation-targeting SA Reserve Bank from its tight monetary

policy. Most economists believe there is a high probability of another interest rate hike in August, and some believe there will one or more hikes after that. With no quick end in sight to rocketing inflation and interest rates that have knocked the economy, struggling homeowners can expect things to get worse before they get better. (ABSA Newsletter, July 8, 2008)

Black Business and Professional Organizations
  Reject Ruling on Chinese

¶5. (U) Black business and professional organizations rejected the Pretoria High Court's ruling defining Chinese South Africans as colored, or "black," for the purpose qualifying as beneficiaries under the Broad Based Black Economic Empowerment Act. "This judgment, in our view revises a long-held historical view of the democratic struggle in SA," National African Federated Chambers of Commerce President Buhler Nthethwa said. "It is our considered view that the responsibility of clarifying legislative and policy ambiguities rest with the legislative or executive arms of government." (Business Day, July 2, 2008)

New Vehicle Sales Slump 21.9%

¶6. (U) The National Association of Automobile Manufactures of SA (NAAMSA) reported that new vehicle sales declined by 21.9% y/y in June 2008. This is 10,956 units less than the 50,020 units sold in June 2007. NAAMSA said the new vehicle sales environment continued to reflect extreme weakness as the current tight monetary conditions continued to weigh on consumer spending. Passenger vehicle sales declined by 7,964 units or 25.8% y/y to 22,861 units in June 2008, while light commercial vehicle sales declined by 3,021 units or 18.2% y/y to 12,975 units during the same period. However, sales of heavy vehicles and trucks increased by 192 units or 9.8% y/y in June ¶2008. Vehicle exports continued to perform well and export sales were supporting the operations of vehicle and component producers, NAAMSA said. Export sales reflected a 52.7% y/y improvement for the

first half of 2008. NAAMSA expects new vehicle sales in the domestic market to remain under severe pressure as a result of the cumulative effect of inflationary pressures, interest rate increases, the National Credit Act, high levels of personal debt, and a slowdown in economic activity. The relatively competitive exchange rate and existing vehicle export contracts should continue to lend support to vehicle and component export activities over the medium-term. (Business Day, July 2, 2008)

Airlines Hesitant to Fly Directly to
Durban's New International Airport

¶7. (U) Rising fuel prices have led Emirates airline to postpone the launch of its direct service from Dubai to Durban, originally scheduled to launch in December. South African Airways (SAA) and British Airways (BA) have also both confirmed they have no plans to operate to the new Durban International Airport at La Mercy. These airlines do not plan to take advantage of the SA Department of Transport's recent approval of direct frequencies between the UK and QTransport's recent approval of direct frequencies between the UK and Durban in 2010. BA told TravelHub that it had "no plans to operate flights to Durban". SAA confirmed that its network strategy was aligned to its restructuring program, which aims to build up Johannesburg as the strongest hub in Africa. SA Board of Airline Representatives CEO Allan Moore explained that the majority of major airlines are members of alliances and rely on the network of feeder flights operated by the home carrier of the alliance. According to Moore, it "is more common to find airlines serving an entry port rather than a number of destinations within a country." Moore noted that the new airport "will have to compete on its own merits to attract the attention of airlines, and airlines will have to see the destination as viable before they consider adding it to their network." Airlines have objected to the construction of La Mercy, saying they had only been consulted on whether or not they would fly there and if so, what their requirements were, after the Airlines Company of SA (ACSA) had already embarked on the project. Lufthansa Swiss Director for Southern & Eastern Africa Gabriel Leupold recently objected to cross subsidization, where Johannesburg-based airlines were funding the construction of La Mercy airport. Gabriel

said, "International airlines will review their markets and decide whether or not to deploy aircraft on a route based on how much business sense it makes to launch a route. Not because more traffic rights have been granted." (Travel Hub Report, July 8, 2008)

Nationwide May Come Out of Liquidation

¶8. (U) The SA press is reporting that Nationwide Airlines could soon come out of liquidation and be taken over by a new airline that will begin operating from Durban International Airport in three months. Nationwide was provisionally liquidated at the end of April and a proposal to buy the airline is currently on the table. Whether the new airline would operate under the Nationwide name or start with a new identity is still being discussed. This move would come on the back of a recent announcement by Emirates to abandon plans for direct flights between Dubai and Durban due to high fuel costs. Nationwide attorney Haroon Laher said he was in the process of drafting legal documents following a successful meeting with the potential buyer this week. A meeting between the company's attorneys and the liquidators will take place next week before the process goes further. If the liquidators approve the transaction, the company will come out of liquidation and a compromise will be sought regarding liabilities to all creditors. "All employees will be considered for re-employment (by the new company)," Laher said. Laher would not give details regarding the identity of the potential buyer or the type of airline the buyer would operate, but media reports said it would operate as a low-cost rival to Kulula, 1Time, and Mango. Laher also confirmed that there were strong indications that the company would use Durban as its headquarters. Some key employees in Durban have already been contacted to establish their availability should the new airline take off. Rumors that the

interested party was associated with Dubai could not be confirmed. (All Africa News, July 5, 2008)

SAG-led AWCC Project Faces Further Delays

¶9. (U) A delay in finalizing the commercial and legal agreements for the consortium that plans to participate in the $510 million African West Coast Cable (AWCC) means that financial closure is now unlikely to be achieved by mid-July as first planned. The AWCC is a SAG-led initiative, which involves the deployment of a 3,840-gigabits-per-second, undersea, fiber-optic cable. State-owned, ICT infrastructure company Broadband Infraco will own 26% of the cable and a range of private-sector participants will own the remaining 74%. The AWCC project will incorporate branching units in at least ten countries along the West Coast of Africa and terminate in London. The AWCC system will follow roughly the same route as the Telkom-controlled South Atlantic-3 (Sat-3) cable, while also competing with the cable that is being built along Africa's East Coast by the U.S.-led SEACOM consortium. However, the SEACOM contracts are finalized and construction is expected to be completed
Qcontracts are finalized and construction is expected to be completed
by June 14, 2009, well in advance of the start of the 2010 FIFA World Cup. Broadband Infraco is leading the AWCC initiative and has admitted that the initial schedule could not be met. Broadband Infraco Director Cornelis Groesbeek explained that the conclusion of the consortium agreement was one of two key requirements for achieving financial closure. Groesbeek assured the press that weekly review meetings are now being held to finalize the agreement. There are reportedly 14 signatories to the process, but Groesbeek said a decision has also been made to release the names of the participants only after the financial deal is finalized. He said Broadband Infraco is currently finalizing the contract terms and conditions for the manufacture and deployment of the cable with a preferred supplier, but he said the name of the supplier will only be made public "once the contract has been signed". He reported that it will take "roughly 27 months" from financial closure to commissioning. This implies a "ready for service date" in the latter half of 2010, after the completion of the FIFA World Cup. "The 2010 traffic will be carried on the upgraded SAT-3 system," Groesbeek asserted. However, he revealed that "2010 contingency plans" have been designed into the AWCC project schedule. "In the event that either Infraco or any one of the private-sector participants needs to carry 2010 World Cup traffic on the AWCC, we will land the cable in Portugal from the Northern Branching unit ahead of the World Cup and then complete the last section of the

system up to the UK after the event," he concluded. (Engineering News, July 9-11, 2008)

ICASA Rethinks its BEE Stance

¶10. (U) Widespread criticism of "unworkable" Black Economic Empowerment (BEE) demands for new high-speed WiMax internet access license bidders have forced the Independent Communications Authority of SA (ICASA) to reconsider its stance. Six new wireless licenses had been earmarked for companies with at least 51% black-ownership. This provoked an outcry that companies that could meet the BEE requirement would lack the cash, skills, and the technical know-how to operate a national network. One of the few companies that believes it has the cash and the skills to succeed is 65% black-owned UniNet, chaired by former Telkom CEO Papi Molotsane. UniNet has sufficient resources from financiers to plan a R1.6 billion ($208 million) expansion. The outcry has prompted ICASA to backtrack and ask the industry to comment on its licensing requirements. An ICASA spokesman would not confirm whether the comments would influence a reworking of the BEE requirements. According to critics, the rules not only prejudice traditional white-owned bidders, but also make it unnecessarily tough on potential black bidders. Internet Solutions Chief Regulatory Officer Siyabonga Madyibi said 51% black ownership was a blatant contradiction to ICASA's existing policy of issuing licenses to

companies that are 30% black, and he would lobby for that to be relaxed. The high black equity demand would deter foreign investors and deprive license winners of foreign expertise, said industry analysts. The new rules stop license winners from merging with larger players for at least five years, so they could not use the license to strike a deal to strengthen their business. That would force them to fund the network themselves, and financiers are unlikely to back a new entrant in a sector dominated by Telkom, MWeb, Internet Solutions and the cellular operators. As companies that qualified for a WiMax license were likely to be relatively new, investors would be loath to take a minority stake that gave them no control over the business. ICASA Spectrum Manager Mandla Mchunu has already admitted that it will be difficult for firms that meet the criteria to succeed in building a national internet operation. ICASA will face a deluge of written complaints, since major technology companies are keen to win the WiMax licenses. Companies are also concerned that the licenses only grant 20 megahertz of spectrum, giving them too little bandwidth to operate effectively. UniNet representatives contend that license operators need at least 30 megahertz to offer a wide range of voice, data and video services. (Business Day, July 9, 2008)

Share Swap and Cash May See Ambani-led
  Group Buy a 51% Stake in MTN

¶11. (U) SA mobile operator MTN has agreed to extend its merger talks with India's Reliance Communications. Bloomberg reported that a group headed by Anil Ambani plans to buy 51% of the MTN Group by offering cash and a share swap. Under this deal, MTN shareholders
Qoffering cash and a share swap. Under this deal, MTN shareholders
are expected to receive cash and shares in Reliance Communications, with the aim of making Reliance an MTN-controlled company. However, the Ambani-led group will hold control over both companies by virtue of becoming a 51% shareholder in MTN. The deal is reportedly structured to ensure that the Ambani group retains shareholding in Reliance telecoms and steers around the right of first refusal controversy that erupted earlier. The initial deadline, which gave Ambani's Reliance 45 days for exclusive negotiations, was extended as MTN needed more time to study the deal. Successful negotiations would lead to the creation of one of the world's top ten cellular companies. Should this deal go ahead, and depending on the structure of the share swap and cash components, there could be an inflow of foreign direct investment to SA. This could go some way in plugging the financing requirement for SA's ballooning current account deficit and reduce some of the downside risks associated with the currency. (ABSA Newsletter, July 8, 2008)

DTI Launches Rural Tourism Promotion Scheme

¶12. (U) The Department of Trade and Industry (DTI) launched the Tourism Support Program (TSP) to boost tourism outside of the existing urban clusters of Cape Town, Durban, and Johannesburg. Minister of Trade and Industry Mandisi Mpahlwa believes the new scheme will encourage growth in the tourism sector across the country instead of just certain areas. Mpahlwa said, "TSP seeks to specifically promote sustainable job creation outside the traditional tourism destination clusters and to encourage greater transformation in the sector by placing a strong emphasis on broadening participation in the sector." The TSP will replace the DTI's Small and Medium Enterprises Development Program (SMEDP), which was shut down in 2006 because "deserving" tourism businesses were not benefiting from the grant system. "Our decision to suspend the SMEDP was done for a good reason, but was misunderstood and criticized by the media," said DTI Director General Tshediso Matona. He said, "It had some major weaknesses and suspending the program was the only way we could fix things." Matona noted that the new program is far more promising in terms of supporting deserving enterprises. Businesses looking for incentive grants will be expected to meet certain criteria in order to qualify. This will include being situated outside of the traditional tourism clusters

defined by the program, achieving a level-four Broad Based Black Economic Empowerment status, and promoting the creation of sustainable jobs. (Travel Hub Report, July 7, 2008)

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